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DIRECTORATE OF INTELLIGENCE

3 May 1982

MEMORANDUM FOR: [redacted] 25X1
Office of Intelligence Liaison
Department of Commerce

SUBJECT : Materials for Deputy Assistant Secretary Denysyk

1. At the end of the briefing that [redacted] and I gave to Bohdan Denysyk and Vincent DeCain on 22 April, Mr. Denysyk asked me to send him some background reading on the Soviet econonmy. 25X1

2. In accordance with his request, I am enclosing the following items:

(1) A briefing prepared by [redacted] Deputy Chief of the Soviet Economy Division of SOVA, "Soviet Economic Planning and Management." The briefing contains a succinct and excellent summary of the key characteristics of the Soviet economy and of how the Soviet economic system operates. Furthermore, though three years old, the analysis of the problems facing the Soviet economy remains valid, relevant, and, for the most part, not at all out of date. 25X1

(2) A much longer paper, "Soviet Economic 'Reform' Decrees: More Steps on the Treadmill," by [redacted] The paper gives an excellent picture of just how disfunctional the Soviet economic system can be, and it might be worth Mr. Denysyk's while to at least skim it. 25X1 25X1

(3) An article by [redacted] of SOVA's Soviet Economy Division, "USSR: Economic Woes Continue," from the "International Economic and Energy Weekly" of 26 March. It gives a very good rundown of economic developments in the USSR in 1981 and early 1982. 25X1

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SUBJECT: Materials for Deputy Assistant Secretary Denysyk

(4) A two page note submitted to the NID by [redacted] of SOVA, on the industrial production results for the first quarter, 1982. 25X1

3. The enclosed package contains little or nothing on Soviet external trade and finance. However, in our phone conversation last week, you said you have two publications that could fill this gap for Mr. Denysyk. They are:

(1) "The Soviet Bloc Financial Problems as a Source of Western Influence," National Intelligence Memorandum, NIC M82-10004, April 1982; and

(2) "Soviet Economic Dependence on the West," An Intelligence Assessment, SOV 82-10012, January 1982.

[redacted] 25X1

Manpower and Planning Branch
Soviet Economy Division
Office of Soviet Analysis

Attachments:
as stated

SUBJECT: Materials for Deputy Assistant Secretary Denysyk

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SOVA/SE/[redacted](3 May 82) 25X1

Soviet Economic Planning and Management

(Briefing given by [redacted] 25X1
to a Conference on Defense Decisionmaking, April 1979)

I. Until recently, the USSR has been able to realize its growth objectives--in consumption, investment, and military hardware--by mobilizing ever increasing amounts of labor and capital. The necessary resources were allocated via the massive state planning and administrative apparatus, which sets prices, production goals, income distribution, investment, and other economic activities that are determined essentially by market forces in Western-style economies. Unlike Western-style economies, however, where budgets are drawn up and resources flow more or less efficiently toward the money, the Soviets establish output targets first--usually in physical terms--and allocate whatever resources they think will be needed to achieve these goals whether such allocations are cost efficient or not.

Goals are set forth in annual and five-year plans--the latter usually reflecting the leadership's priorities for the development of the economy while the former act as a substitute to some extent for the market mechanism, coordinating the activities of thousands of economic units. In the annual plans, adjustments are often made to deal with problems and shortfalls of the previous year. These adjustments, in turn, may alter the original goals of the five-year plan. Indeed, no Soviet five-year plan has yet attained all of its original targets. Nevertheless, since the investment strategy worked out in a five-year plan affects the size and composition of production capacity over time, the five-year plan presents both general guidelines and a fairly narrow range of choices to those who fashion the annual plans.

No matter which plan we are talking about--annual, five-year, or even longer--there have been four primary factors underlying the resource allocation decisions articulated in the formal plan:

1. national policy objectives;
2. the size and diversity of the USSR;
3. the attitude of Soviet planners that resources are inexhaustable; and
4. bureaucratic inertia.

Taken together these four factors, as I shall try to demonstrate, have interacted to drive resource allocation decisions in a pattern that has become increasingly difficult to change and that leaves Soviet leaders with relatively few options in the years ahead.

First, national policy objectives. Since the beginning of the Soviet system, national policies have consistently reinforced an overriding commitment of labor and capital resources to heavy industry: the industrialization drive of the 1930s; the post-war reconstruction effort; the catch-up policies of Khrushchev; the goal of self-sufficiency in natural resources and, as a corollary, securing the economic dependence of Eastern Europe; and finally the drive to achieve technological parity or superiority vis-a-vis the West both economically and militarily.

Thus, in terms, of national objectives, it has always been easy for planners to justify the allocation of more resources to heavy and high technology industries, which in large part also happen to be those contributing either directly or indirectly to the Soviet defense effort.

The size and diversity of the country has also played a large role in resource allocation decisions, and, has generally provided planners with more justification for allocation decisions that favor both defense and heavy industries. The far flung locations of natural resources; the length of the Soviet borders; the harsh climate; the need for transportation and communication facilities; and the desire of the non-Russian populations to "get their share" of Soviet industrial development (which they generally equate with heavy industry) have all led Soviet planners down a one-track path in allocating resources.

The third factor influencing resource allocations is the planners' attitude, up to now at least, that natural resources are inexhaustible. The growing pinch on resources which I spoke of in the previous briefing did not suddenly spring up, but has been in the making for some time--in large part the result of inept planning and an approach to resource management that follows the maxim ...."damn the reserves-to-production ratios; full speed ahead." For the past half century, the ready availability of raw materials has fueled the USSR's extensive growth model, and Soviet leaders have maximized the short-term exploitation of these resources with little or no thought to their potential depletion. Not only have natural resources been underpriced in terms of scarcity, but the perverse Soviet incentive system has rewarded overfulfillment of short-sighted production goals, regardless of how much of the resource may have been wasted, or rendered unusable, in the process. When efficiency in extraction was considered at all it usually was in terms of maximizing labor productivity--an indicator that generally declines as resource deposits get deeper or more difficult to work.

A similar attitude has prevailed with respect to labor and capital. That is, labor seemed always to spring from somewhere, often from the womb of plant managers who had squirreled it away as a hedge against unrealistic plans. So planners could feel secure in levying taut plans for production, knowing that if productivity goals fell short, they could always count on more labor to fill the gap. This was made possible, in the past, through the massive influx of rural farm labor to the urban industrial areas. However, this source has all but dried up, leaving planners with no alternative but to face up to the issue of productivity. By 1977, for example, the size of the industrial labor force already had exceeded the 1980 plan. More significant, annual increments of industrial employment, which constituted about one-fifth of the country's total employment growth during 1971-75, increased to one-third of the total in 1976-78. With smaller annual increases in the labor force coming, a continuation of this trend could create labor shortages in other sectors of the economy.

In terms of capital goods, well, every good Soviet planner knows that machine building--the key to capital goods production --has been, is, and always will be the fastest growing sector in the Soviet economy. And besides, what the machine builders can't make, the foreign trade sector can import.

Now this may all sound a bit facetious, but it's quite important in assessing the flexibility of Soviet planners. While the Soviet command economy has the advantage of granting its leadership the ablity to enforce a set of priorities reflecting national objectives, it also fosters a significant degree of inflexibility in coping with domestic and external economic changes. Indeed, our interviews with Soviet emigres who have either worked in the planning system or have had close contact with those who do, testify that planning is more iterative, and bureaucratic than flexible and scientific.

For example, and this leads me to the fourth factor driving resource allocations in the USSR, <u>bureaucratic inertia</u>. Within GOSPLAN, the extrapolation of existing structural proportions seems to be the jumping-off point for discussion and political jockeying in setting goals. In terms of annual plans, this means a more or less straight-line projection of this year's growth to next year's plan. Moreover, [redacted] 25X1
has claimed that those 25X1
with a decisive role in planning share a broad general conception that heavy industry must grow faster than consumer goods production, and that in no branch of the economy can an absolute decline be planned. Yet, in some sectors there must not be too much growth--since this may put plan fulfillment by the ministry

in jeopardy. Although it is the ministry in the first instance that takes the heat if the plan is not met, a poor track record by the ministry can begin to reflect poorly upon the GOSPLAN department that set the plan.

Finally, each department within GOSPLAN depends upon other departments for inputs to its plans. Moderate input requirements foster good relations, while large requirements cause problems. If one department has good relations with another department, it will receive the information it needs to complete its plan; in this instance, the first plan variant will be the last one and the work involved can be kept to a minimum. The poorer the relations with other departments, however, the more plan variants that have to be calculated before the final one. And the more difficulties a department chief has with other departments, the more poorly he is evaluated by his superiors. Thus, there are substantial incentives for department chiefs to go along with existing proportions and avoid antagonizing colleagues in other departments.

The upshot of all this has been a pervasive tendency of the system to reproduce itself in the same mix of output and the same pattern of investment for decades.

Moreover, because of the pulling and hauling at the planning level, resource allocations never quite dovetail with requirements and enterprise managers, therefore, are often forced to augment their allocations in ways that frustrate attempts to use resources more efficiently.

Fulfillment of output goals is the overriding success criterion of every plant manager. This compels him to hoard resources as insurance againts (1) an overly taut plan, (2) equipment breakdowns, and (3) disruptions in the supply of intermediate goods--all of which occur with nearly clock-like regularity in the Soviet system.

The obsession with plan fulfillment also fosters risk aversion among plant managers, thus inhibiting the introduction of new technology or equipment which might temporarily disrupt the production process and jeopardize plan fulfillment in the short run. Thus, the assimilation of new technology occurs very slowly in the Soviet economy, which will only compound the inflexibility of the system to adapt to the resource-short environment of the 1980s.

Even when planners begin to focus on the conservation of resources (and there are some indications that they are beginning to do just that), the inability (and often unwillingness on the part of plant managers) to rapidly absorb new labor- and materials-saving technology will hamper efforts to conserve. This may prove critical in the case of energy. Because the energy consumption structure in the USSR is dominated by heavy industry, major gains in energy-efficiency have to be obtained largely by upgrading industrial technology--a very time-consuming, capital intensive process--or by major shifts away from heavy industry and toward light industry and services, a shift contrary to the view of dominant Soviet interest groups.

In planning for the 1980s, however, Soviet leaders will be under increasing pressure to reconcile national capabilities and constraints. And economic constraints will be primary. As yet, no clear strategy has emerged to deal with the problems that are building in size. Instead, the leadership has been temporizing on policy decisions; reacting rather than redressing. In terms of energy production, for example, Moscow has responded to short-term needs for oil with a crisis management approach; rushing more men and equipment into West Siberia to step up drilling and recovery operations at the expense of sharper production declines in some of the older producing regions.

Devoting more resources to Siberian energy development and to problem sectors such as steel, however, may mean reduced allocations to others. Indeed, data on investment allocations last year as well as plans for 1979, though scanty, suggest this is happening. Investment in oil, gas, and coal jumped abruptly in 1978, and equally large increases are planned this year. In fact, of the 3.5 billion ruble increment to total new fixed investment planned this year, three billion has been allocated to the energy branches and 0.4 billion to agriculture. Apparently, Soviet leaders are counting heavily on reductions in the backlog of unfinished investment projects to provide increases in the capital stock of most other industries. The hard-pressed steel industry also is being favored in investment allocations which in 1978-79 will have increased at an average annual rate of 16 percent. However, this represents a very large jump last year followed by a planned decline in 1979. Year-to-year shifts such as these may continue for some time as the needs of individual sectors are met from more limited investment resources and as more emphasis is placed on reducing unfinished projects.

The current investment allocations in favor of energy reflect Brezhnev's strategy for priority development development of these sectors. Since the December 1977 Central Committee Plenum, Brezhnev has consistently favored a heavy commitment of resources to oil and gas production in West Siberia. Because of the severe environmental conditions here, the accompanying demands for pipe and equipment will place increasing strain on the steel and machinery sectors. Moreover, by stressing development of West Siberian oil and gas, Brezhnev has heightened the need for a broad range of sophisticated on-shore and off-shore technology, much of which will have to be imported if the best and quickest results are to be achieved.

Thus, the Soviets may continue to look to the developed West for advanced technology and equipment, both to maintain energy production levels and to compensate for domestic deficiencies in modernizing other industrial sectors. However, the import of western technology could prove unsatisfactory as a basic tenet of Soviet growth strategy if the domestic economy remains no more capable than in the past of generating its own technical progress. First of all, the industrial sector is so large that the overall impact of imported technology will be marginal. The overwhelming proportion of the nation's annual increments in capital equipment will have to come from domestic production. Hence, unless the general level of domestic technology improves, the contribution of technological progress to overall growth is likely to remain small. Second, the technology of advanced western countries may fail to mesh well with existing Soviet equipment, available labor skills, and methods of operation. Unless the broad level of technological and managerial skills in the USSR increases substantially, imported equipment is likely to operate at lower levels of productivity than intended by the exporting country, or expected by the Soviets, thus losing some of the gains from trade.

Third, and most important, the USSR cannot expect to project itself into the ranks of the leaders in the generation of new technology by relying on imports for its most advanced technology. The lead times for the advanced and rapidly changing technology are such that by the time the equipment is imported, it will already have begun to obsolesce. Imported technology, therefore cannot serve as a substitute for a technologically innovative economic system. While some gains will occur from imports, they will be mostly temporary. Soviet engineers will note well what foreign designers have done--but, not having gone through the designing experience, will be ill prepared to carry the design to a still more advanced level. Nevertheless, pressure for large increases in imports of western technology and equipment will likely continue, and may become more acute, in the 1980s--particularly as the USSR strives to locate and exploit new oil and gas resources to counter any decline occuring in the present sources.

During the next decade, Soviet planners must also come to grips with growing regional imbalances in the soruces of labor, capital and natural resources. As I indicated earlier, from now until the late 1980s increments to the labor force will come almost exclusively from the Moslem areas of Central Asia and the Transcaucasion republics. However, most of the growth in natural resources, especially energy, is occurring east of the Urals, while the bulk of capital goods is still produced mainly in the European areas of the country. Thus, problems in supply and distribution, which have continually plagued industrial enterprises, may become more acute. At a minimum, the already over-taxed transportation system will play an even more crucial role than in the past in bringing goods and services together at the right time and in the right place. This, in turn, will increase the demand for fuels as well as machinery to modernize and increase the stock of transportation equipment.

Continued expansion of military hardware systems will add yet another dimension of stress to Soviet industrial resources--particularly in the machinery and metals sectors. Judging from Moscow's efforts to increase defense spending throughout the Warsaw Pact last year and Brezhnev's speeches since November 1978, production of military goods still seems to be the front-runner in the leadership's resource allocations decisions.

Thus, the factors that have driven resource allocations for some 60 years are, for the moment at least, continuing to exert influence. A continuation of the policies which have promoted, and been supported by, the development of heavy industry and defense production, however, could squeeze the USSR's resources to the point where something has to give. This, in turn, may have implications for leadership debates over civilian vs.

military resource allocations, the more so as marginal changes in resource allocations take on increasing importance in the 11th Five-Year Plan period (1981-85) and beyond. For example, under mounting pressure to minimize current outlays for defense, military planners may attempt to tailor future programs so as to minimize current outlays without bringing growth in military capability to a standstill. The question is, can they? Maybe, but it won't be easy.

First of all, the Soviet military establishment has never operated under a constraint to maximize "the rumble for the ruble". Indeed, maximum rumble at any ruble generally has been the rule. Second, it is not at all clear that those programs which may be considered vital to maintaining "the proper posture" of military capability (whatever that means) would be consistent with a cutback in the growth of current outlays (particularly if there is substantial inflation in hardware costs).

Finally, the feasible combinations of growth in GNP and defense spending will change through time. As energy and labor shortages take their toll in the next decade, less growth will be possible with any given rate of decrease in military investment. On the other hand, the same increment in economic growth might be more desirable to the leadership when GNP is growing at 2 percent than when it is growing at 4 percent. How such a debate might conclude is impossible to say. Certainly, there would be plenty of room for argument among contending factions.

Even without this complicaton, resource allocation decisions are not likely to get any easier for Soviet planners in the years ahead. First, growth in total investment will continue to slow as long as the machine building and metal working sectors that turn out capital goods are on the wane. More important, the USSR's dependence on the resources of Siberia--where costs are high, labor is short, and infrastructure is often nonexistent--means investment projects will be more costly and their payoff further away. Thus, Soviet planners will have to make judgments about the cost-benefit ratios of alternative projects whose major benefits may lie chiefly in externalities that are as yet dimly perceived. To the extent that planners remain obsessed with applying short-run criteria to long-run investment decisions, industrial and economic growth is likely to fall still further in the 1980s and beyond.

Soviet Economic "Reform" Decrees: More Steps on the Treadmill [redacted] 25X1

A Research Paper

Information available as of 2 April 1982.

This paper was prepared by [redacted] 25X1
consultant to the Office of Soviet Analysis.

Comments and queries may be addressed to the Chief,
Soviet Economy Division, Office of Soviet Analysis, on
[redacted] 25X1

Soviet Economic "Reform" Decrees: More Steps on the Treadmill

Contents

Soviet Economic "Reform" Decrees: More Steps on the Treadmill [redacted]

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Overview

In July 1979 the Soviet leadership promulgated a decree setting forth new measures to improve planning and performance of the economy. This decree, together with its more than 80 implementing regulations and a July 1981 amendment, is no more likely than its predecessor of October 1965 to contribute much to raising the economy's efficiency. Indeed, by forcing managers to spend more time coping with increasingly complicated regulations, the latest round of "reforms" may make matters worse.

The principal goals and features of the new arrangements, presumably to be in effect in the 11th Five-Year Plan and beyond, are as follows:

- To improve planning by focusing on five-year plans rather than annual plans and on integrated planning of a few large, comprehensive programs. Plans are to be "balanced" (in terms of input-output relationships) and are to remain stable for the five-year period.
- To bring prices more in line with costs by introducing new industrial wholesale prices on 1 January 1982 and by establishing a new charge for water usage and sharply raising social insurance taxes.
- To replace a major success criterion--the notorious "val," which leads enterprises to prefer expensive inputs--with another indicator, "normative net output" (average value added).
- To tie enterprise and worker incentives to a variety of five-year plan targets, measured in physical units as well as in rubles and focused on raising efficiency and product quality.
- To require all entities--from enterprises to ministries--to finance their operations from their own funds and bank credits, rather than

receive partial funding from the state budget.

- o To make the investment process more effective by requiring that approved plans remain unchanged for the five-year period, that all plans be backed with the requisite material and financial resources, and that bank credits rather than customers' funds be used to finance construction in progress.

Many of the new measures are aimed directly at resolving of two problems that Soviet planners rightly regard as especially critical--limiting the demand for labor and economizing on the use of fuel and raw materials. Because increments to the labor force will decline drastically during the 1980s, the authorities must limit labor demand to supply to keep the growth of wages in line with slower growth consumer goods and services. This effort goes hand in hand with the need to boost labor productivity by squeezing out the hidden labor reserves that Soviet planners believe are ubiquitous. The new measures include compilation of regional labor balances, imposition of employment ceilings, tightening of work norms, tying managerial bonuses to meeting plans for labor productivity, allowing firms to keep the wages saved by meeting plans with a reduced workforce, and organizing work brigades as a means of imposing group discipline. Although these measures should aid the planners in managing the difficult manpower problems they face, probably the most effective factor will be that extra workers will simply not be there.

Other measures are intended to cope with shortages of critical raw materials that currently are threatening to strangle the economy. These measures include a greatly expanded role for plan targets focused on savings on such resources per unit of output, imposition of tighter input reduction norms in physical terms, and directly tying incentives to meeting targets. The new prices will raise the cost of most raw materials, and the shift to net output targets is intended to remove the incentive to maximize the use of intermediate inputs. Considered individually, most of these measures have something to recommend them. But their effectiveness will be severely diluted by the fact that, as so often in the past, new rules add new indicators but do not really get rid of the old ones. There simply are too many indicators pulling enterprises in all directions. Also, in an essentially unchanged environment, the response of enterprises to new cost relationships is likely to be sluggish and limited.

Various measures are aimed at improving economic performance in general. The new planning emphases reflect the Soviet planners' idee fixe that better plans will guarantee better performance. Eleven of the much touted comprehensive programs have been included in the 1981-85 plan. Many more plan balances are being prepared than ever before. An array of new incentive arrangements aimed at improving product quality and a complicated new state certification procedure have been introduced. Still other provisions and organizational rearrangements are designed to solve the perennial problems created by the cumbersome system of distributing material inputs to producers, notably a greater role for contracts and stiffer penalties for violations. A package of financial provisions is aimed at eliciting more efficient operations everywhere. Finally, new centralized organizational structures have been set up to coordinate several large programs and to oversee the campaign to enforce raw material and energy savings.

The "new deal" as now being implemented substantially increases the scope and rigidity of central planning and the authority of Gosplan and the ministries. Many more plan balances are compiled at the center, and many more parameters are fixed centrally. Gosplan itself is taking on the role of a quasi-ministry, planning and overseeing a growing number of special projects and comprehensive programs. The central ministries are more than ever the final arbiters of the maze of rules and incentive schemes governing activities of producing units and have more centralized funds under their control. As a consequence, the producing units, whether labeled enterprises or associations, are more fettered than ever. The new rules of the game enmesh them in an even denser thicket of plan targets, norms, rules, and incentive schemes than did the prior working arrangements. The new incentive systems are especially intricate; at least a score of bonus plans are in operation, and managerial rewards depend on at least eight major variables. The scope for conflict among the multiple factors determining managerial rewards is great, the potential for optimizing (economically efficient) calculations by managers small, and the possibility of new behavioral abberations enormous.

Soviet planners--and some Western observers--put considerable faith in the efficacy of the program to gradually require all ministries and their enterprises to adopt a fixed profit-sharing scheme with the state budget and to finance all expenses from their own funds and bank credits, rather than from budget grants. As now structured, however, the profit-sharing scheme requires ministries and enterprises, rather than the state budget, to bear all the risks of failure and to reap only a small share of the reward for success. Moreover, managers do not have discretion over the use of retained profits in any case. Self-finance, it is argued, will induce firms to use inputs more efficiently, to be more demanding of suppliers of raw materials and investment goods, and to cater to customers' wishes. In a word, producers, while remaining part of a state-managed production system, are supposed to respond like business firms in a competitive market environment. Such an expectation is a grand illusion. With no alteration in the economic environment, financial autonomy amounts merely to a change in accounting rules. To make it effective, firms would have to be given broad freedom of action, alternative suppliers would have to be available, prices would need to reflect relative scarcities and utilities reasonably well, and government bureaucracies would have to retreat to guiding the economy rather than directing it through detailed plans. None of these systemic modifications are in the latest reform package.

This round of "reforms" is riddled with contradictions, stemming both from the excessively large number of modifications and from their complexity. Although plans are to be carefully balanced in terms of input-output relationships, several incentive schemes encourage enterprises to alter those relationships during the plan period. These schemes also conflict with the intent to keep plans stable--itself an unrealistic objective in a world of change. Enterprises and their workers are supposed to display initiative and creativity in an environment of increased bureaucratic constraint. Multitudinous resource-saving norms and manpower ceilings are imposed in order to force savings, but potentially serious distortions in output mixes may result as a consequence. Price incentives are introduced to induce reduced usage of scarce raw materials and to upgrade product quality, but central allocation of those materials makes substitution difficult, and the overriding emphasis on meeting production plans in physical units relegates quality considerations to secondary importance.

The latest round of extremely intricate changes in planning and incentive arrangements provides no panacea for the ills of the Soviet economy. Those ills stem largely from three fundamental features of the system: (1) the lack of a reliable (efficient) guide to choice; (2) the attenuated influence of consumers on producers and (3) the absence of the discipline of competition among suppliers. Even with reformed prices, the Soviet economy will continue to be a ship without a compass. The absence of efficient prices deprives all derivative value categories--sales, value of net or gross output, profits, profitability--of genuine economic content. Thus, efforts to induce economizing behavior from producers by tying rewards and penalties to meeting targets for any or all of these categories are doomed to failure. Enterprises can be expected to respond to the modified incentive structure by focusing on those aspects of performance that they perceive have highest priority in the judgment of superior bodies. As before, these are likely to be outputs and indicators of resource savings expressed in physical units. Manipulation of product mixes in the interest of meeting one or another value target, for example, profits, is likely to be pursued, as now, in the interest of meeting the plan rather than the requirements of customers.

The above information is **Confidential**.

Soviet Economic "Reform" Decrees: More Steps on the Treadmill 25X1

Introduction

In July 1979, the CPSU and the Council of Ministers adopted the omnibus Decree No. 695 setting forth a wide range of measures intended to improve planning and the performance of the economy. This decree represents the second major attempt of the Brezhnev leadership to deal comprehensively with the chronic ills of the so-called economic mechanism.[1] The first attempt was embodied in the set of measures launched in October 1965--usually referred to as the Kosygin reforms. As implemented, those measures (1) restored the traditional system under which sectoral ministries manage economic activity, (2) carried out a major revision of industrial prices, centralizing administration of prices in a newly formed agency--the State Price Committee, (3) attempted to centralize the rationing of producer goods in a new agency--the State Committee for Material-Technical Supply, (4) raised the operational role of the five-year plan, which was now to be based on detailed long-range scientific and technical forecasts, (5) instituted a new system of incentives for enterprises focused largely on sales and profitability (return on capital), and (6) gave enterprises a little more freedom in managing labor and investment. These measures, having failed to produce the desired results, were modified several times over the next decade. Indicators of product quality and labor productivity were added to the list of determinants of managerial rewards, and incentives were supposedly linked to fulfilling contractural obligations. On the planning front the five-year plan was made legally binding at the same time that a system of counterplanning was introduced. In the process, many experiments were officially endorsed, all designed to uncover so-called hidden reserves and to remove one or another aberration prevalent under existing arrangements.

The comprehensive July 1979[2] Decree and over 80 follow-up issuances:

- o Reinforced the shift of the focus of planning and incentives from annual plans to five-year plans, which are to be balanced and to remain stable.
- o Authorized the major industrial price reform of 1 January 1982.
- o Revised the system of plan indicators and incentives to emphasize targets based on net output rather than gross output.
- o Upgraded the role of so-called comprehensive or program-goal approaches to planning and management of economic activity.
- o Outlined a program for gradual transfer of all economic entities to complete self-finance, beginning with industrial ministries.
- o Attempted to make the investment process more effective by requiring that approved plans remain unchanged for the 5-year period, that all plans be backed with the requisite material and financial resources, and that bank credits rather than customers' funds be used to finance construction in progress.
- o Detailed a number of other measures aimed at solving particular problems or removing particular sources of inefficiency.

The 1979 Decree and subsequent implementing regulations have set the planning and incentive arrangements that, unless subsequently modified, are to prevail during the rest of the 1981-85 plan and beyond. They are intended to enable the USSR to cope with declining productivity growth rates and growing resource constraints of unprecedented severity. Factor productivity declined during the 1970s. Throughout the 1980s, the growth of the labor force will be only half that in the 1970s. Production of critical materials -- fuels, minerals, steel and lumber -- has slowed considerably, and costs are rising sharply. Agricultural output has nearly stagnated, and costs per unit of output are also rising. Growth of the capital stock has slowed, and the return on investment has declined steadily. Thus, the USSR must substantially raise the return on resource inputs if economic growth is to continue even at modest rates. Equally urgent is the need to radically improve the quality of output and remove the distortions in product mix that reduce the contribution of production to the economy. Soviet planners perceive these problems in all their severity. In addition to reducing growth targets, shifting investment priorities, and introducing policies designed to augment the growth of the labor force, they are counting on the latest modifications in the working arrangements of the production system as spelled out in the July 1979 Decree. The decree has engendered a burst of bureaucratic activity that has produced an avalanche of follow-up decrees, instructions, methodologies, and the like. Some amend provisions of the July 1979 Decree, as does a major new party-government decree (published in July 1981) dealing with measures to elicit savings in energy and raw materials.

This paper will describe the new working arrangements now being introduced and assess their likely impact on economic performance. It will focus, in turn, on three critical imperatives identified by Soviet planners themselves -- the need to limit the demand for labor, the need to economize on raw materials and energy, and the general need to obtain more utility in terms of desired, efficient final output from combined inputs of labor, capital, and raw materials. Several of the new measures are aimed at solving all three problems. The impact of the new measures for the comparability of Soviet economic data is considered in the appendix.

Limiting the Demand for Labor

Soviet planners are convinced, correctly, that successful management of the quasi-market for labor in the 1980s requires severe restrictions on the demand for labor because there is little scope for augmenting supply beyond the small additions resulting from growth of the working-age population. Demand must be limited to supply, both nationally and locally, in order to limit the growth of money incomes to match planned of goods and services. The effort to limit demand for labor at the level of individual enterprises also is part of the effort to raise labor productivity, especially by reducing gross overmanning. Some of the July 1979 Decree measures are directed specifically at balancing supply and demand, especially in local and regional markets; others are aimed at reducing demand for workers in individual firms, both by fiat and through targeted investment and incentives. Both types of measures are to be carried out in an economic environment featuring reduced growth of investment and serious efforts to restrict building new enterprises, which have larger staffing requirements than an equivalent capacity achieved by expanding and modernizing existing plants.

Labor Balances

Not only will total labor force growth be slow in the 1980s, but rates of growth will differ widely among republics and administrative subdivisions. To provide a framework for assessing the critical regional dimension of the problem as well as the possibilities of coping with it, both five-year and annual balances of labor supply and requirements are now to be compiled for republics, krays, oblasts, rayons, and major cities. These balances are to be disaggregated by sex, sector, and skill level. Gosplan is required to submit the balances for the USSR and the republics to the Council of Ministers for approval. The State Committee on Labor and Social Problems is supposed to play a much larger role in this planning process, as are regional planning committees and local soviets. The central authorities ordered all enterprises, beginning in 1980, to submit their planned requirements for manpower to local soviets for review prior to sending the plans forward to ministries.[3] Also, ministries were ordered to supply subordinate enterprises with labor mainly from local sources and through intra-ministerial redistribution, rather than through centralized distribution (orgnabor). Finally a major party-government decree of March 1981,[4] codifying some of these arrangements, ordered enterprises, regardless of subordination, to present their entire annual plans to local soviets, which are to review all matters concerning manpower and to confirm changes that affect labor requirements. The press reports a great deal of local activity in the field of labor planning. In the comprehensive plans for development of Leningrad and Moscow, for example, there are separate sections for labor; local authorities claim considerable success in restricting the growth of the labor force in their regions.[5]

In determining manpower needs at all levels, planning authorities are to be guided by tightened norms (planning factors) relating number of production workers to output and by leaner staffing patterns for white collar employees. This requirement, specified in the July Decree as implemented in a Gosplan instruction,[6] calls for a review of the entire system of norms underlying the determination of labor requirements in industry to make them more "progressive", that is, tighter. "Progressive" norms are also to be employed both in calculation of the planned wage fund, which is to be set on the basis of norms relating average wages to output, and in establishing the wage components of the values of net output for industrial products promulgated in January 1982 along with the new wholesale prices. Labor norms (for example, wages per ruble of output) are supposed to be consistent among the various uses to which they are put.

Incentives for Economizing on Labor Usage

The new arrangements, like their immediate predecessors, make success in meeting labor productivity targets an important determinant of the size of economic incentive funds and managerial bonuses. Other new planning features are intended to reinforce this generalized incentive to save labor. The new rules require that the wage fund be determined on the basis of stable coefficients relating wages to output (wages per ruble of output.)[7] As noted, these norms are to be based on "progressive" manning factors and generally are supposed to remain unchanged during a five-year plan. Moreover, any savings in the wage fund beyond planned amounts are to go into enterprise incentive funds. This procedure, already adopted in over 2,000 enterprises, in effect carries on the 1967 Shchekino experiment (an effort to meet prodouction plans with fewer workers at the Shchekino chemical plant).[8] Normative wage planning is scheduled to be introduced in 18 ministries in 1981 and in the remainder by 1983.[9] As under the Shchekino plan, enterprise managers are allowed to use wage savings to pay bonuses (up to 50 percent of regular wages) to workers who take on two jobs or similarly raise productivity. The new rules continue to penalize managers for wage overexpenditures, by charging them to the enterprise bonus fund and reducing managerial bonuses in the period in which the overexpenditure occurred.

Manpower Ceilings and Other Measures

The new arrangements contain other stringent requirements. First, beginning in 1980, ceilings on the number of employees were imposed on ministries and on enterprises.[10] Although the implementing instructions seemed to apply everywhere, evidently they were enforced only in industry. The industrial labor plan was only slightly exceeded in 1980, but there were complaints about failure on the part of many enterprises and ministries to observe the ceilings.[11] In late 1981, the Council of Ministers adopted a decree stating that beginning in 1982 annual plans will set an employment ceiling for all ministries, departments and union republics.[12] The decree also specifies sectors in which employment growth rates are to be reduced and those in which employment levels are actually to be cut. Although some economists are urging penalties for violation of manpower ceilings, at present, penalties for overmanning operate only indirectly through the penalties for overexpenditure of the wage fund and for reduced labor productivity.

Second, the price of labor is being raised beginning in 1982 because of a large rise in the social insurance charge (from an average 7.5 percent of the industrial wage bill to a top rate of 14 percent). Third, the 1981-85 plan adds a new target to enterprise plans -- a reduced number of manual workers in the total of production workers. Under the bonus statute, the ministry can make that target a determinant of the size of managerial bonuses. The idea is to substitute machines for men, freeing them for work elsewhere; thus, the instructions for implementing the new target require enterprises to submit lists of released surplus manual workers and their qualifications to local manpower offices for assignment.[13] Finally, workers are to be organized into brigades, mobilizing group pressures to meet production and productivity goals, with reinforcement provided by group bonus schemes.

Economizing on Use of Materials and Energy

The new working arrangements attack this objective, economizing on materials and energy use, on several fronts: (1) stiffer plan norms governing material usage; (2) establishment of material usage and cost-reduction targets for enterprises, with incentives tied to meeting those targets; (3) adoption of net output, rather than gross output or sales, as the principal measure of the volume of production; (4) revised methods of measuring output in physical units; and (5) price revisions.

Planning Norms

The normative base for planning and allocating raw materials and energy is being revised to enforce reductions in materials consumption per unit of product. Guidance for this vast effort at norm revision and extension was provided in the Gosplan issuance of January 11, 1980--"Concerning a System of Progressive and Technical-Economic Norms and Normative Measures for Their Introduction into Planning."[14] The system is to include norms relating to labor, materials, investment, and finances. Although a 1981 article criticized ministerial and other lower level planning and research agencies for the slow pace of work in forming the revised set of norms,[15] stiffer usage norms undoubtedly were incorporated into the 1981-85 plan.

Resource-Saving Plan Targets for Enterprises

In the 1976-80 plan, Gosplan established annual targets for reduction in materials usage per unit of output for 39 major raw materials. These targets were established centrally in enterprise plans, but evidently were not well enforced. The fact that incentives were not tied directly to their fulfillment probably had something to do with the shortfalls (although some sectors had special bonus arrangements for rewarding workers for saving on the consumption of particular fuels or raw materials). In the July 1979 Decree, for reduction in materials usage is among the plan targets for enterprises designated as "centrally established." Incentive arrangements for meeting those targets have been, in effect, left up to ministries; they may establish materials-use targets as determinants of incentive funds and managerial bonuses.

A major CPSU-Council of Ministers decree, published in July 1981,[16] changes these arrangements substantially. Major provisions of the new decree are:

- Gosplan and other responsible agencies are directed to expand the list of materials for which usage-reduction targets are set and, beginning in 1982, to establish specific materials consumption norms for especially large materials users.
- In industry, construction and transportation, beginning in 1983, cost targets are to be fixed centrally and are to include explicit limits on material expenditures expressed in rubles per unit of product.
- Beginning in 1983, enterprises will be allowed to transfer to their incentive funds any monies saved by reducing material expenditures below the assigned limit; conversely, exceeding that limit requires reductions in the funds of as much as 25 percent of their originally planned amount. In addition, beginning in 1982 and 1983, enterprise employees are to be given bonuses related to the material savings achieved compared with the limits set.
- Starting in 1982, additional groups of workers are to be paid bonuses for reducing material expenditures below those set in the new "progressive" norms.
- Responsible agencies are to review existing standards for products and services to reduce their materials-intensiveness, and penalties for violating standards will be stiffer. Special arrangements for economizing on the use of scrap metals were instituted in a CPSU decree on the subject issued in May 1980.[17]

Shift to Net Output Targets

For decades, both Western and Eastern economists have pointed out the economic damage resulting from the use of gross value measures of output (GVO) to evaluate performance of enterprises. In the 1970s, numerous experiments were conducted to test the use of the net output measure defined in various ways. The July 1979 Decree orders the change to the use of this measure, wherever it is appropriate. (However, gross value measures and value of sales must still be calculated and reported). In general, net output is defined as gross output less purchased materials and depreciation and is equivalent to the sum of wages and profits, or value added. The transition to the net output indicator is to be made gradually, ministry by ministry; such targets were fixed in the plans of four ministries in 1981, with the rest scheduled to adopt the new measure in 1982 and 1983.[18]

The primary purpose of the transition to net output as a measure of plan fulfillment is to eliminate the revealed preference of managers for producing material-intensive output; the weightier and more expensive the inputs, the higher was the value of total output and the easier it was to meet the plan. With plan fulfillment evaluated by net output, the argument goes, enterprises no longer will have an incentive to favor material-intensive products, or in the case of machinery to goldplate them. If they do so, costs will be increased and profits, a major element of net output, will be reduced.

Net output values (rather than gross values as before) are now to figure in evaluation of plan fulfillment with respect to output, labor productivity, and value of products in the highest quality category -- the three major determinants of bonus funds. For a given enterprise, the total output will be determined, as now with respect to gross output, by summing net output values for all products, with the net output value for each one calculated as the product of the quantity produced and the normative net output value fixed for that product. Thus, normative net output for a given product is a species of price. The values were fixed by the State Committee for Prices and issued to enterprises simultaneously with the new wholesale price lists that took effect on 1 January 1982. A normative net output value is calculated for each product as the average branch-wide value added for the product. Specifically, it is calculated as the sum of wages of industrial-production personnel, social insurance charges and profits, expressed per unit of output. Thus, normative net output values are fixed in accordance with the principles used for setting producer prices in general. It should be noted, though, that the profit rates used in setting net output values are expressed as percentages of cost (sebestoimost') after deducting average material expenditures included in the wholesale price for the product.

Revised Physical Plan Indicators

The July 1979 Decree instructed Gosplan to review the physical measures that (a) figure importantly in compiling of material balances in planning, (b) are a key component in enterprise production plans, and (c) determine a manager's right to be paid bonuses. Gosplan was directed to find ways of incorporating into physical measures of output such factors as utility, quality and "progressiveness." The aim was to remove the distortions and reduce the gross wastes created by measuring output simply in tons, meters, or number of units. Gosplan has announced that new physical indicators (unspecified) have been developed for 15 kinds of materials handling equipment, and "improved" measures for 70 kinds of machinery.[19] Having found no way to avoid planning ferrous metallurgical products in tons, Gosplan has now determined that "dual indicators" are to be used for that sector and for some kinds of machinery. The indicators in the case of steel pipe are tons and linear meters. Just how this dual system of indicators is supposed to work in practice is not clear, (that is, which one shall have precedence in determining whether plans have been met).

Prices

Although relatively few details of the new prices that took effect in January 1982 have been released yet, those for fuels, electricity, and other raw materials are scheduled to increase substantially. Coal and natural gas prices are to rise by 42 to 50 percent and oil prices by even more. Substantial increases have also been indicated for electricity, ferrous metals (20 percent), nonferrous metals (14 percent), and commercial lumber (40 percent).[20] In contrast, prices of many kinds of machinery and chemical products are scheduled to decrease. Aside from bringing prices into line with production costs, higher prices for energy and raw materials, coupled with revisions in incentive arrangements, are intended to promote conservation in general.

Improving Planning, Management and General Economic Efficiency

This section considers an array of innovations not specifically directed at obtaining savings in labor or raw materials, but rather intended to improve the functioning of the economy in general, including, of course, the efficiency in its use of those specific resources. We group the many changes under the following rubrics: (1) upgrading product quality, (2) improving the functioning of the wholesale distribution system, (3) revision of wholesale prices, (4) strengthened financial "levers," (5) changes in planning approaches and technologies, and (6) changes in organizational structures.

Upgrading Product Quality

In general, the round of changes in working arrangements stemming from the July 1979 Decree strengthen ongoing approaches. Thus, meeting plans for raising the share of output classified in the highest (H) quality category in total production, now to be assessed on the basis of net rather than gross output,[21] continues to be a generally mandatory indicator for forming incentive funds and for determining managerial bonuses. Price markups for products awarded the State Seal of Quality are increased substantially and the duration of the markups is lengthened.[22] Producer goods in the highest quality category may be priced with profit markups 50 to 125 percent higher than normally allowable rates. Profits from sales of goods with these price markups are allocated as follows: 70 percent to enterprise incentive funds, 15 percent to the ministry's central fund for financing research and development, and 15 percent to the state budget. Price rebates are imposed on production of goods in the lowest quality category (II) and on sales of output that was not certified as to quality on schedule: profits from such sales are confiscated in whole or in large part by the budget.

The procedures for state certification of the quality of industrial products are codified and strengthened by a Council of Ministers Decree issued in December 1979 and a follow-up Gosplan methodological instruction of June 1980.[23] All industrial products other than specifically excepted categories are to be submitted for quality certification to state certification commissions. Commissions are set up for individual products or groups of products as appropriate. The membership of a commission consists of representatives of the producing ministry (but not the enterprise producing the product), the ministry of the principal consumer of the product, the ministry designated as "head ministry" for making the product, the State Committee for Standards (Gosstandard), and, if appropriate, the State Committee for Construction, the Ministry of Foreign Trade, the Ministry of Domestic Trade, or a republic Ministry of Services for the Population. The commission must be chaired by a representative of the consumer ministry or the State Committee for Standards (or Gosstroy), and he must vote yes on any quality certification that is to be valid. In each case, the commission issues a certificate of quality, which is formally registered with Gosstandard and specifies the time limit on the validity of the certificate (1 to 3 years); it also recommends to the producing ministries whether a product certified in the lowest product category (II) should be modernized or dropped from production. Enterprise annual plans specify schedules for submitting products for certification. When products are produced in violation of standards, sales of that output are not counted in the value of production for plan fulfillment evaluation, and enterprise incentive funds are reduced as a further penalty.

Finally, the government continues to push adoption of plantwide quality control programs, and the press lauds local and regional bodies that adopt areawide programs. To encourage enterprise willingness to produce high quality products and new kinds of machinery, the new rules state that supervising ministries may revise enterprises plans when failure to meet them occurs because an enterprise is mastering the production of high quality producer goods or new consumer products.

Improving the Functioning of the Wholesale Distribution System

First of all, the perennially balky system of rationing and distributing producer goods is to be made to function better by ensuring that both annual and five-year plans are balanced. This means, among other things, increasing the number of products for which these balances are made. For the 1981-85 plan, Gosplan compiled material balances for 409 products and distribution plans for 331, compared with 234 balances and no distribution plans in the previous plan.[24] Gosplan's distribution plans encompass 75 to 85 percent of output of the products concerned. In the 10-year plan now being worked on, Gosplan is compiling balances for 168 products. In annual plans, Gosplan makes balances for 2044 products, 331 balances requiring approval of the

Council of Ministers. Gossnab makes annual balances for 7500 products, and the ministries for 25,000.[25] For the first time, regional plans contain material balances for five-year periods. Also, for the first time the five-year plan contains a separate section for material-technical supply.

The 1979 Decree and several followup issuances continue and attempt to reinforce previously decreed programs. Use of long-term contracts between enterprises is to be extended. By 1990, long-term contracts are supposed to encompass 80 percent of total industrial production of the relevant goods.[26] Already, they cover substantial shares of iron ore and steel products, cement, timber, and agricultural machinery. In 1980, there were 136,000 of them, involving some 12,000 enterprises and associations (27 percent of the total). Producers of consumer goods are to sign five-year contracts with appropriate retail organizations, mainly units of the Ministry of Trade. These so-called direct ties are supposed to remain stable and to be arranged to promote efficiency in the distribution process. Two major new official issuances regulate procedures for concluding these contracts and relations between buyers and sellers, providing stiffer financial penalties for violation of contract terms.[27] In addition, failure to deliver goods as specified in contracts results in deductions from incentive funds of the delinquent enterprise and denial of all or a part of bonuses to its managerial personnel. Finally, Gossnab is both to enlarge its network of small wholesale stores, where enterprises can purchase items without ration tickets, and to expand the practice of negotiating contracts with large enterprises or associations to supply them with all needed materials and equipment as a package deal.

To provide for handling bottlenecks and smooth out the production process in general, the 1979 Decree calls for building up Gossnab reserve stocks.

Implementing this provision, Gosplan and Gossnab issued a decree providing for the setting of new reserve stock norms for 132 groups of products in the 1981 -85 plan period. The new norms are substantially higher than those planned for 1980--three to four times as high for rolled ferrous metals, 1.5 times for steel tubing, two times for trucks, and four times for armored cable.[28] These stocks are a part of the system of reserves of the Council of Ministers, intended for general use in the economy as needed, but strictly controlled.

Revision of Industrial Wholesale Prices

A major revision of industrial wholesale prices, the first overall revision since 1967, took effect on 1 January 1982. The set of changes is in no sense a price reform, since the traditional Soviet approaches to administrative price fixing are retained intact. Thus, the new prices, like those they replace, are calculated on the basis of average unit labor, material, and depreciation costs plus an average percentage profit markup over cost. Excepted are crude oil and natural gas prices, for which a species of marginal cost pricing is used. Although little price information has been released thus far, several features of the new system have been described.[29]

First, the new prices will bring costs and prices generally into line by substantially raising prices of fuels, raw materials and many manufactured products. The overall level of prices will be raised by an as yet unspecified amount; retail prices are to remain unaffected. The new prices are intended to enable the average enterprise in each branch to earn a normal profit, so that branches such as coal mining, peat, and lumber, will once more become profitable. On the average, the new prices provide profit rates ranging from 12 to 15 percent among the various branches;[30] the profit rates are calculated relative to cost after deducting material expenditures.[31]

Second, the new prices incorporate certain costs that heretofore had been covered by the state budget from general revenues. Social insurance charges, which in industry range from 4.7 percent to 9 percent among branches, are to be increased by an average of 50 percent, with rates ranging to a maximum of 14 percent.[32] The new prices are to cover all costs of geological prospecting work, only about half of which had been covered previously. The stumpage fee, which is a cost to lumber users and is paid to the budget to finance forest management, is to be doubled. Finally, product costs underlying the new prices will include a charge for use of water, which beginning in 1981 will be imposed differentially on enterprises and will be paid into local budgets.

According to statements at a recent conference on price fixing, the State Committee on Prices has revised and promulgated nearly 2,000 price lists--300 all-union lists and 1270 republic lists; altogether, some 900,000 individual prices and tariffs have been reviewed and approved.[33] Although details are sparse, it appears that the new price lists generally provide for finer differentiation to take account of relative quality, utility, and scarcity. In the case of crude oil prices, which are to rise 2.3 times, the number of regional price zones has been cut from 17 to three; within each price zone the base price will be set so as to cover costs of the highest cost producer. Other producers will, as was the case before 1979, pay rent (fixed payments) to the state budget calculated in rubles per ton. A uniform industrial wholesale price is to be set for all consumers. Finally new estimate prices and norms for construction are scheduled to take effect on 1 January 1984.

Strengthened Financial "Levers"

Several types of so-called levers are to be strengthened and extended under the new arrangements. They concern use and payments for bank credits, establishment of centralized ministerial funds to be used for financing research and development, and gradual transfer of ministries and enterprises to a system of fixed profit sharing with the budget and to self-financing. With respect to bank credits, revised procedures and rates were introduced in a Council of Ministers decree. Beginning on 1 January 1981, bank monitoring of enterprise finances was increased, higher interest rates were imposed for a variety of stipulated infractions, such as overdue loans, and fines were levied on customers for failure to pay for orders on time.[34] Finally, enterprises are expected to use bank credits rather than budget grants to an increasing extent, and construction firms are to use bank credits rather than customer advances to finance projects in progress.

To centralize funds for financing research and development, introduce new technology into production, and promote its mastery, the July 1979 Decree provides for establishing in industrial (and presumably other) ministries a single, "unified" fund to finance the planned R and D program and to reimburse enterprises for experimental production and startup costs. Except for a few ministries experimentally using the single fund, such costs previously had been financed in a variety of ways--but mainly from funds charged to enterprise production costs, contract receipts of research and design institutes, and the state budget. The new fund in each ministry is to be formed by a levy on enterprise profits calculated as a branch-wide percentage of the value of net output (marketed output in some branches). The rates are to remain fixed for the five-year plan, and expenditures from the fund are to be carried out on the basis of stable planned allocations. Levies for the unified fund will constitute a major charge on profits--they amounted to 12 to 26 percent (average 12.7 percent) of profits in some of the ministries.[35] In addition to profits, the fund is to be allocated a part of the price markups allowed on high quality products.

Even under the new arrangements, some R and D work will still be financed from budget funds and bank credits. The norm for forming the unified fund is to be set by the ministry concerned, based on its experience and its planned tasks for research and for mastering new technologies and products. It is argued that these unified R and D funds will improve ministerial oversight and direction of the R and D process and provide a better vehicle for repaying enterprises promptly for startup costs; failure to do so under the old arrangements was blamed for enterprise reluctance to innovate. Meanwhile, ministerial R and D institutes and design organizations are to be completely transferred to a system of self-finance, and rewards to their personnel are to be based on profits obtained. In the case of individual projects, bonuses are to be related directly to the estimated "useful effect" (cost savings) obtained by users from adopting the results of the projects.[36] Contracts are to be concluded to cover each large individual project ordered by a client enterprise, with payment for work to be made only when the entire project has been completed and accepted by the client. The institutes and design organizations are to arrange bank financing in the interim.

Ostensibly to motivate ministries and their subordinate units to strive for greater overall efficiency and to show concern for capital assets, the July 1979 Decree directs the transfer--"as they are ready"--of all industrial ministries to partial self-financing based on profit sharing. Long advocated by some economists and resisted tooth and nail by the bureaucracy, this arrangement was put into effect as early as 1971 in the Ministry of Instruments and Means of Automation (Minpribor) and extended with modifications to four other central ministries and a few local units. Two additional central ministries and some union republic ministries adopted the system in 1981.[37] Procedures for transfer to the new arrangements have been spelled out in a Gosplan instruction issued in February 1980, with no timetable specified.[38] Ultimately, the ministries are supposed to apply the system of profit distribution and self-finance to all subordinate enterprises and associations.

As spelled out in the July 1979 Decree and Gosplan's instruction, the system is supposed to work as follows. The affected ministry (and subunit) shall be assigned a fixed amount of profit in rubles that must be paid into the state budget in each year of the five-year plan; the rest of the profits are to belong to the ministry (or subunit) to finance planned operations, but strictly in accord with plan. The budget's allocation must be paid, even if the annual profit plan is not met. If the profit plan is overfulfilled by 3 percent or less, half the excess profits go to the budget; if overfulfillment is greater, 75 percent of the excess profits go to the budget. The budget's fixed amounts as well as all other rules of the game are supposed to remain unchanged during a five-year period. The budget's share of planned profits is supposed to be set as the sum of (1) the planned capital charge and fixed payments and (2) the difference between total planned profits and all other planned uses. Budget funds and bank credits may be used in cases where planned profits are not sufficient to cover planned investment and other requirements. Finally, ministries and their units must pay the capital charge on above-norm inventories out of the part of profits planned to be retained by them. Units using less capital than planned, and thereby realizing a savings on the capital charge, may keep the savings.

Planning Approaches and Technologies

A major section of the July 1979 Decree is devoted to the theme of improving planning, continuing the idee fixe that better plans will produce better, that is, more efficient performance. Although none of the approaches adopted in this round of reforms is new, some of them receive much greater stress than in the past. First, the decree aims to accomplish in the 1981-85 plan what was supposed to (but did not) happen in the past two plans--namely, making the five-year plan the center of focus. The plan is to remain stable, it is to be subdivided by years, and the incentive mechanism is geared to meeting five year goals; that is, the size of bonus funds and rights to bonuses depend on meeting an annual plan that reflects its cumulative contribution to meeting those goals. Second, even greater stress is placed on the system of counterplanning, whereby enterprises and their personnel are rewarded for voluntarily adopting an annual or five-year plan that sets higher targets than those set for the enterprises in the original plan. Third, the elusive "balance" in the input-output relations embodied in the plans is to be ensured, this time by considerably increasing the number of planned balances developed at the center, notably the already numerous material balances and plans of distribution. Regional plans are to be made more realistic and balanced by giving a larger role to local planning agencies. This aim was embodied in yet another government decree (published in March 1981) increasing the powers of local soviets relative ~~with regard~~ to central ministries by requiring that the latter obtain concurrence of the soviets for those parts of their plans (and any changes in them) that concern matters of "land use, environmental protection, construction, use of labor resources, production of consumer goods, and local infrastructure serving the population."[39] Material balances are to be developed by republic for the five-year plan, and labor balances by region and locality for annual and five-year plans. Fourth, more plan targets and associated norms are to be specified for enterprises by the center, and in greater detail than before. Fifth, the second phase of the computerized planning scheme (ASPR) is to be put into operation; its purpose is to speed up planning and raise the quality of plans through use of mathematical optimizing models and input-output techniques. Sixth, great stress is placed on ensuring that plans remain stable for the five-year period, particularly investment plans that are to be fully backed by appropriate allocations of inputs and, once approved, are not to be altered.

Seventh and last, but not least, this round of planning innovations substantially upgrades the status of and importance attached to so-called comprehensive or program-goals planning approaches, with the aim of focusing attention and resources on national or regional problems that cut across many sectoral lines. Also involved here is the desire to base five-year and long-term plans on the most realistic and comprehensive long-term scientific and technical forecasts possible. In this way, Soviet planners hope to reap the fruits of the scientific-technical revolution. The rhetoric on this theme has become a floodtide, whose real essence is frequently murky indeed. There are three basic types of these comprehensive programs--scientific-technical programs (nauchno-tekhnicheskiye programmy) intended primarily to guide scientific research and development; targeted economic programs (tselevyye kompleksnyye narodnokhozyaystvennyye programmy) aimed at coping with an economy-wide problem, and comprehensive programs for developing a particular region (territorial'no-proizvodstvennyye kompleksy). Gosplan has promulgated methodological directives for preparing plans for such comprehensive programs.[40]

In May 1980, according to A. Bachurin, a Gosplan deputy chairman, Gosplan, Gostekhnika, and the Academy of Sciences formally ratified a list of 40 comprehensive scientific-technical programs and 120 programs to solve specific scientific and technical problems; most of these programs are to be implemented in the 1981-85 plan and the rest in the 1986-90 plan.[41] The same spokesman also states that 14 key "economic, social and technical programs" will be developed on the basis of published Gosplan methodologies "in the near future;" among them are programs for reducing the use of manual labor, stimulating more efficient use of fuels and energy, conservation of metals, expanding production of new consumer goods and development of the Baikul-Amur railroad (BAM) area. The Gosplan spokesman then states, "Development of the food program will be important for the nation."[42] An editorial in the April 1981 issue of Gosplan's Planovoye khozyaystvo organ states that "comprehensive programs should become an integral part of the new five-year plan. Priorities are food, development of the production of consumer goods and services, reduction of manual labor, upsurge of machinery, energy and transport, and likewise other large-scale programs."[43]

The directives for the 1981-85 plan do not list any specific comprehensive programs, although they do refer to seven specific territorial-production complexes or regional comprehensive programs: Western Siberia, Kansk-Achinsk, South Yakutia, Timano-Pechora, Kursk Magnetic Anomaly, Sayan, and Pavlodar-Ekibastuz.[44] The directives also state the intent to continue the comprehensive program for developing the Non-Black Soil Area. Writing in the February 1981 issue of Gosplan's journal, Zhimerin, deputy chairman of Gostekhnika, also refers to the 160 programs approved for the 1981-85 plan, stating further that 38 of them have been singled out as especially important, targeted programs.[45] He states that these programs provide for all necessary measures and assignments of responsibilities for carrying them out. He also mentions complex programs for fuel and energy, 13 programs for machinery, 18 programs concerning the agro-industrial complex, six of them targeted (one for grain). Coordinating commissions consisting of leading scientists and specialists have been approved for the programs. Some of the programs for the plan period provide for timetables for organizing serial production of new products based on completed research and design work, thereby reducing the usual large time gap between completed reserch and the mastery and production of products. In the January 1982 Ekonomicheskaya gazeta, Gosplan Deputy Chairman Bachurin wrote that only 11 designated comprehensive programs had been included in the finally approved five-year plan.[46]

Changes in Organizational Structures

The July 1979 Decree specifies that the formation of production associations as the basic production unit in industry shall be completed in the "next 2 to 3 years." At the end of 1980, there were 4,083 production and science-production associations; they accounted for 48.2 percent of total industrial output.[47] Although the associations are supposed to merge enterprises, in fact more than two-fifths of their constituent units are independent enterprises.

In his speech to the 26th party congress, Brezhnev stressed the need to develop organizational forms to better coordinate activities of the numerous branch ministries in matters that cross sectoral lines. But the July 1979 Decree is silent on the matter, and the 1981-85 plan directives are vague. The decision seems to have been taken to accomplish the coordination process by proliferations of special commissions of the Council of Ministers and Gosplan and by appropriate reorganization of the internal structure of Gosplan. The following actions have been reported:

- A commission of the Council of Ministers was set up, probably in 1980, to oversee development of the West Siberian oil and gas complex; an interdepartmental commission under Gosplan was located in Tyumen.[48]
- A party-government decree of July 1981 established an interdepartmental commission under the Council of Ministers for conservation of raw materials, fuel and energy.[49] Its chairman is V.

N. Martynov, head of the State Committee for Material-Technical Supply. Counterpart commissions are to be set up in republics, krays, and oblasts and also in individual ministries.

- In 1981, a new State Committee for the Supply of Petroleum Products was established under the Council of Ministers;[50] its chairman is T.Z. Khuramshin. Apparently, this new committee takes over the functions of a network of petroleum product supply administrations that were subordinate to republic Councils of Ministers and to the State Committee for Material-technical Supply.
- Gosplan has established several interdepartmental commissions--for energy, for BAM, for rationalizations of freight shipments, for use of secondary raw materials, for the food program, and for comprehensive use of useful minerals.[51] Ya. P. Ryabov, a Gosplan first deputy chairman, heads the last two commissions mentioned.
- The internal structure of Gosplan has been reorganized to establish a number of comprehensive departments concerned with major targeted programs.[52] Details of the new internal structure have not been revealed.
- Two new ministries with activities related to the so-called Food Program have been created. They are the Ministry of the Fertilizer Industry and the Ministry of the Fruit, Vegetable, and Canning Industry.

The New Working Arrangements -- In the Right Direction?

In no sense do the working arrangements set forth in the July 1979 Decree and its successors constitute a reform of the economic system. Quite the contrary. Planning is more centralized, rigid, and detailed than ever; the scope for initiative of the producing units is more circumscribed; producer goods are more tightly rationed; administratively set, inflexible, average cost-based prices are retained: and intricate incentive systems are tied to meeting plans for many potentially conflicting variables, with priority given to production plans expressed in physical units. These changes move the system in a direction opposite from what most Western (and some Soviet) observers agree is needed--decentralization, flexibility, and introduction of market elements.

Increased Centralization

The "new deal" now being implemented substantially increases the scope of central planning and the authority of Gosplan and the central ministries. It does so by increasing the number of products whose production is planned and allocated by Gosplan itself. Moreover, Gosplan is taking on the role of quasi-ministry for a growing number of special projects; technically, these projects are allocated materials and equipment separately from the ministries normally responsible. Gosplan itself determines project requirements, and the number of so-called fundholders has proliferated as a result (from 92 in 1965 to 136 in 1970, 176 in 1975, and 303 in 1981.[53] A little over one-third of fundholders in 1981 were ministries and the like, and the rest special projects of one kind or another (mainly in construction). The changes also reinforce the central role of the industrial ministries, which under the new arrangements are the arbiters of the formal rules and norms that govern subordinate units--whether enterprises or associations. In practice, the ministries administer the maze of incentive arrangements, interpreting them in ways that ultimately determine the incomes and careers of enterprise managers. They have an array of discretionary reserve funds that can be used to affect the fortunes of subordinate units and their employees. Above all, the ministries are in a key position to delay implemention of those formal arrangements (for example, profit sharing) that they regard as inimical to the welfare of themselves and their enterprises. By attempting to do more and more in greater and greater detail in Moscow, the central agencies--Gosplan, other state committees and the ministries--have become more than ever "leather-jacketed Commissars working around the clock to replace the free market," to borrow the words of Alec Nove.

New Planning Contradictions

Three themes dominate the new emphases and arrangements pertaining to plans themselves: stability of plans and the underlying normative base oriented toward a five-year period, plan balance, and comprehensive, program-goals approaches. The goal of plan stability is to be accomplished largely by fiat, by declaring that plans and their normative underpinnings shall not be altered for the plan period. This declared intent is simply not realizable; to pursue such a goal is to chase a chimera. Planners cannot foresee the future, forecasts everywhere are likely to be frequently in error, and change and uncertainty are the essence of life. In practice, not only will frequent alterations in plan targets continue, but indeed, must continue. Failure to adjust targets to take into account actual changes in supply and demand would simply compound the rigidities and inefficiencies endemic to the Soviet production system, perhaps even bringing it to a halt.[54]

In this round of adjustments in economic working arrangements the long sought balance (consistency between planned outputs and the requisite inputs) is to be accomplished in both annual and in five-year plans through proliferation and modernization of the time-honored system of norms relating inputs to outputs and through an ukaz declaring that no investment project is to be included in a plan for a given year or five-year period unless it is fully backed with the requisite input allocations. In pursuit of the elusive balance and the even more elusive efficiency in plans, Gosplan has been overseeing a massive effort to review, update, and proliferate norms of all kinds throughout the economy. Presumably, some initial results of this undertaking have formed the underpinnings for the 1981-85 plan. On paper, of course, the production plan can be balanced by adjusting input output norms and norms governing schedules for constructing and assimilating production capacities. No doubt ~~this plan and all~~ future plans when announced will be declared to have been carefully balanced. There is no reason to think, however, that in practice matters will be any different from those of the past. Events will show no doubt that the original norms were too optimistic about input requirements and mastery of new capacities. Moreover, even if the originally planned normative relationships were realistic at the time of formulation, they involve technical forecasts and output projections, both of which may be in error because of unpredictable real world events, for example, unexpected difficulties in new plants and processes or ~~and~~ crop failures. Meanwhile, the much larger ~~attempt to greatly increase the~~ number of input-saving targets that are set for enterprises increases the potential for error, and monitoring and enforcing the targeted savings will add greatly to the administrative burden on the bureaucracy's. Finally, an added contradiction is inherent in the scheme of counterplanning, where enterprises undertake to do more than the approved plan requires and are rewarded for doing so.

The notion of comprehensive, goal-oriented planning seems sensible. In fact, however, ~~the~~ superimposing ~~of~~ this type of planning on to established routines ~~for solving large-scale problems or developing a large region--~~ immensely complicates the planning processes in an economy that is ~~since its inception has been~~ centrally administered along sectoral lines. Because of rampant increased centralization and retention of sectoral management, all of the existing planning routines and computations must be retained. Now, the already overburdened central bodies must compile detailed plans for each of the many complex programs, ensure that their inputs and outputs are provided for and are consistent with all other sectoral plans, and see to it that the detailed requirements of a given program are introduced as separate line items in thousands of ministerial, sectoral, and enterprise plans so as to ensure implementation of the program. This is a herculean task. At the moment, Gosplan evidently is trying to cope with at least 11 comprehensive economic and perhaps 60 scientific-technical programs. In this effort, Gosplan is spawning new departments and commissions, not only to plan the programs but also to take an active part in their implementation. Thus the administrative burden on higher echelons multiplies, and so will the economic inefficiencies stemming from excessive centralization of decisionmaking.

Fettering the Producing Unit

Although production associations are slated to become the basic ~~producing~~ unit ~~for~~ in industry by 1985, experience with them in the 1970s suggests that their formation has made little difference. The press confirms that formation of associations has involved much formalism, with many of their constituent units still retaining the status of independent enterprises with separate balance sheets. Many associations consist of only 2 or 3 plants; the desired concentration and specialization have not taken place to any extent, and the anticipated large benefits have yet to materialize. Rather, their formation, to the extent that actual merger has taken place, has increased the average size of Soviet industrial enterprises, already excessive by international standards. The millions of small, independent, efficient subcontractors--so much a part of the industrial structure in Western countries--have yet to appear on the Soviet scene. The latest set of changes in working arrangements, including formation of the associations, is not conducive to their emergence. Because of the scarcities of real inputs looming in the 1980s, the pressure for self-sufficiency (having one's own sources of supply) will ~~in fact~~ be greater than ever.

Although one objective of the new arrangements is to provide for the proper combination of centralized planning with enterprise independence and initiative, the new rules of the game enmesh the producing unit and its managerial staff in an even denser thicket of targets, norms, rules, and incentive schemes than did the previous working arrangements. The list of centrally-set plan goals and norms for enterprises is longer than before and covers everything that matters: growth of output (net or gross) in value terms; production of principal products in physical units, many more than before; growth of output of products in the highest quality category; growth of labor productivity; norm wages per ruble of output; number of employees; assignment for reduction of manual labor; normatives for forming each of the three incentive funds and the fund for financing R and D; total profits; commissioning of new production capacities; ruble ceiling on invest-ment; assignments for new products and introducing new technologies; indicators of the technical level of production, for example, extent of automation or quality of products; economic benefits to be obtained from introduction of R and D work; allocations of principal raw materials and machinery; targets for reduction in use of principal physical resources, many more than before; and (in annual plans only) all of the foregoing plus sales of products and payments to and assignments from the state budget (also set for five-year plans, if a fixed profit-sharing arrangement has been adopted). Moreover, the July 1981 Decree adds, beginning in 1983, goals for production cost with a ceiling on the value of raw materials included in cost. Besides these centrally-set targets in its plans, the association or enterprise is supposed to conform to the requirements of labor norms and staffing patterns, product standards and requirements for product certification, and numerous other rules governing one or another aspect of its operations.

The new arrangements add considerably to the already mazelike intricacy of the incentive schemes that are supposed to motivate enterprise personnel, particularly managerial staffs, to strive to produce more with less. Although there is considerable diversity, the general rules are as follows. First, more than a score of diverse bonus schemes are in effect. Second, the basic bonus funds from which the bulk of managerial bonuses are paid are formed from profits, and their size depends on enterprise performance with respect to labor productivity and the share of products in the highest quality category. Because various kinds of profits are omitted in figuring deductions into the funds, their size is affected by the system of counterplans, by enterprise performance in meeting contracts, and by some other variables. Third, even with money in the bonus funds, the amount of an individual manager's bonus for a particular month or quarter depends on meeting the plans for labor productivity, product quality, and profits; his entitlement to any bonus or a part of it requires fulfillment of those three plans and also meeting the plans for production of key products in physical units and for product deliveries under contracts. Bonuses are reduced for overexpenditures of wage funds, and ministries may specify additional requirements. Moreover, there are ceilings on the total bonus a manager may be paid. Finally, in 1983, managerial bonuses are to be made dependent also on the actual amount of material expenditures as compared with the limit set. Obviously, the scope for conflict among these multiple factors determining managerial rewards is great, the potential for optimizing (economically efficient) calculations by managers is small, and the potential for new behavioral aberrations enormous.

Although it is unlikely that ministries and enterprises will shift soon to a profit-sharing system and financial autonomy, some observers believe that the proposed change has considerable potential for inducing more efficient enterprise behavior.[54] To us, however, the scheme has no such potential, a major reason being that it creates an incentive arrangement where the ministry or enterprise bears all the risk if it fails and reaps a sharply decreasing share of the reward if it succeeds. The new arrangements, thus, are not a true profit-sharing system; rather, they guarantee a fixed amount of taxes to the budget during each year and five-year period to be paid regardless of the amount of actual profits. The enterprise bears the entire cost of failure to meet the profits plan, regardless of the reasons for that failure; conversely, if the enterprise makes additional profits above those planned, the budget automatically receives half or more of the extra profits. Thus, should an enterprise seek to maximize its profits, most of the reward for extra effort would go to the state treasury. Moreover, under both this and the present scheme, the enterprise is in no sense the residual claimant to profits with discretion as to their use. Under both schemes, the uses to which all profits can be put are specified by plan or regulations. The government evidently believes that managers cannot be trusted to decide such important matters as how best to allocate the fruits of enterprise endeavor.

Profit sharing is part of a broader scheme of requiring ministries and ultimately firms to operate under conditions of complete financial autonomy, paying for all operations from profits and bank credit without budget subsidies or investment allocations. This step, it is argued, will induce units to use inputs more efficiently, to be more demanding of suppliers of raw materials and investment goods, and to cater to customers' wishes. In a word, the relevant entities, while remaining part of a state-managed production system, are expected to respond like business firms in a competitive market environment. Such an expectation is a grand illusion. Without any alteration in the economic environment, financial autonomy can amount to no more than a change in accounting rules. To make it effective in inducing the desired behavior, firms would have to be given broad freedom of action, alternative suppliers would have to be available, prices would have to reflect relative scarcities and utilities reasonably well, and government bureaucracies would have to retreat to overseeing the economy rather than directing it through detailed plans. None of these systemic modifications forms any part of the latest reform package.

Impact on Management of Human and Material Resources

Together with the reduced rate of investment, the complex of measures directed mainly at limiting enterprise demand for labor and better coordinating supply and demand in local labor markets may ease those difficult tasks somewhat. Probably, the most effective labor-saving factor, however, will be that the extra workers will simply not be there, so that managers will be forced to make do as best they can. They will find it hard to bid away workers from other firms by offering higher wages, for it is evident that the financial authorities are determined to enforce strict control over wage expenditures and staffing patterns. Their record in this area has been rather good in recent years. The delegation of responsibility to local governments for compiling supply-demand balances for their regions and taking more responsibility for dealing with local problems is a positive step.

These revisions in working arrangements, besides being directed at coping with a long period of low growth in labor supply, are aimed at reducing the demand for intermediate goods (raw materials and energy). These measures include an expanded role for plan targets focused on such savings, tying these targets to the formal incentive system, and a shift from gross to net output as the primary value measure for enterprise production. The new wholesale prices also are structured to the same end--that is, prices of fuels, metals and lumber will rise sharply relative to prices of final goods such as machinery. The entire system of norms, both for materials and labor, is being revised to make them taut; it is these new norms that will underlie plan targets for specific material resource savings, for labor productivity, and for cost. Tightened input norms and limits on resource use are parts of a proven method--a system of routines and pressures that in the past has enabled the economy to improve in the physical efficiency of resource use--tons of steel or kwh of electricity per million rubles of machinery or construction. Tying material resource savings and cost reduction to the bonus system is new, despite the abortive attempt made in the early 1960s. The difficulty is that these incentive arrangements are only part of an incredibly complex system of rewards and penalties. The most notable innovation is the adoption of net output, in place of the val, as the primary measure of the value of enterprise production.

The new rules add new indicators but do not really get rid of the old ones, thus proliferating conflicts and inconsistencies in the structure of regulators, rewards and penalties that confront producing units and their managers. Thus, val continues to be a feature of the system, because firms are set targets for sales (sold val), which for all practical purposes is the sum of contractual obligations, broken down as always into physical units and their corresponding prices. Managers' bonuses depend on meeting plans for contractual obligations and for the key products in physical units. In such an environment, rife with potentially conflicting signals, the need to pay at least some attention to yet another variable--net output--will produce its own aberrations. Indeed, some press reporting has already alluded to such possibilities, and has reported their appearance in the behavior of enterprises already experimenting with the net output measure.[56] Because the principal component is wages, enterprises may be led to prefer labor-intensive products. Also, the revealed preference for producing those products that an arbitrary pricing system has made most profitable may well be enhanced by the new indicator, one prominent minister has already declared that to be the case in practice.[57]

These new working arrangements attack the problem of upgrading the quality of Soviet products and involve continuation of the incentive arrangements and the grading of products by quality that has been in effect since 1972. An outpouring of statistics would seem to support belief in a "great leap forward" in the average quality of Soviet products. As of October 1, 1980, over 85,000 products, accounting for 15.2 percent of the gross value of industrial output, had been awarded the Seal of Quality, signifying that their specifications were up to the best in the USSR and fully met world standards.[58] In 1975, the share was 6.5 percent. During the 1976-80 five-year plan, the shares of output assigned to the highest quality category for various kinds of machinery reportedly increased as follows: power transformers--from 40.18 to 53.2; metal cutting machine tools--from 19.2 to 44.2; forge and press machinery--from 16.3 to 39.7; machinery industries as a whole--from 18.5 to 32.6.[59] In light industry, however, the share was only 7.1 percent.[60] Data of this kind are also given for particular ministries. That these statistics reflect actual achievements is open to grave doubt, because (except for a few machines, such as cars and ships), Soviet exports of machinery to the West did not rise, and because factor productivity in industry has continued to deteriorate, despite the infusion of all of those supposedly high-quality machines.

The new price markups provide higher profit rates for new and high quality products, so as to encourage their production in competition with highly profitable old products that constitute the bulk of output. Thus, sale of highest quality products in 1980 contributed only from 1.8 to 8.6 percent of the total profits among 12 machinery ministries, with an average of 3 percent for all machinery.[61] The new mandatory product certification procedures, along with substantially higher profit markups and the longer duration allowed on new and more efficient products and machinery, may indeed induce producers to put out such products. Whether the outcomes will be real or spurious depends on whether products certified as meeting world standards actually do so. One would expect to find evidence of product quality in the increased salability of Soviet manufactures in world markets, increased efficiency of domestic production, diminished unsellable stocks, and fewer complaints by consumers.

The extremely intricate working arrangements that constitute the latest round of changes in planning and incentive arrangements are no panacea for the ills of the Soviet economy. Those ills stem largely from three fundamental features of the system: (1) the lack of a reliable (efficient) guide to choice; (2) the attenuated influence of consumers on producers and (3) the absence of the discipline of competition among suppliers. Even the reformed prices will be poor indicators of real resource costs. The absence of efficient prices deprives all derivative value categories--sales, value of net or gross output, profits, profitability--of genuine economic content. Thus, efforts to induce economizing behavior from producers by tying rewards and penalties to meeting targets for any or all of these categories are doomed to failure. Enterprises can be expected to respond to the modified incentive structure by focusing on those aspects of performance that they perceive have highest priority in the judgment of superior bodies. Manipulation of product mixes in the interest of meeting one or another value targets, for example, profits, is likely to be pursued in the interest of meeting the plan rather than the requirements of customers. Response to new relative prices for labor and materials is likely to be slow and limited.

Indeed, an argument can be made that any really serious effort to implement widely the latest basket of innovations in planning and management will make matters worse. The greatly increased centralization and complexity of planning will push the bureaucracies to the limits of their capabilities. The perennial changes in the rules of the game facing the producing units distract their managerial staffs from the business of running their firms and make decisionmaking at that level extremely difficult. The avalanche of regulations, norms, and incentive rules directed at reduced use of physical resources, together with the campaign-like approach that is being used to help solve this problem, is unlikely to induce resource savings at rates any higher than in the past. In fact, many economically inefficient consequences could ensue from this approach, which seems to be based on the notion that "any reduction in energy or metal or labor per unit of output is a universal good." This fixation would preclude decisions in particular cases, for example, to produce a product with higher content of steel per unit of output, even though that product would sell easily or enable some producer to reduce his product costs. These economically efficient choices are denied the Soviet economy because of inefficient guides to economic choice and the lack of consumer guidance of production. The absence of these features over a half century of production activity and politically motivated choice has produced a pattern of physical resource use that deviates in millions of detailed ways from an economically efficient pattern. These distortions have now become so pervasive that they constitute severe fetters on production. Bit by bit, the physical production plant has been put out of kilter throughout the entire production-distribution chain. The present round of reforms does nothing to put it right. [redacted] 25X1

APPENDIX

Impact of New Arrangements on Economic Data

Adoption of the new prices in 1982 will affect the comparability of some series of economic data, certainly for industry and probably ultimately for most other sectors. Specifically:

- Production cost (sebestoimost') now will include all geological prospecting costs; only a part of such costs had been previously included.
- Cost will include increased stumpage fees to cover all costs of forest maintenance.
- Cost will include an average 50 percent increase in social insurance taxes, which differ among branches.
- Cost will now include a new differentially levied charge for industrial use of water.
- Cost will no longer include the explicit charge levied differentially to cover part of ministerial research and development outlays.
- Profits will now be charged with a substantial levy to finance the new centralized R and D funds of ministries.
- The Soviets may elect to calculate the official index of industrial production on the basis of net output instead of gross output. In any case, they surely will shift the price base for the index to 1982.
- Payments for bank credit are likely to become a significantly larger charge on profits than before.

- Budget revenues will be swelled by the new or higher charges for geological prospecting costs, stumpage fees, water levies, and social insurance charges. The contribution of profits to budget revenues can be expected to drop relative to that of the turnover tax and other revenues.

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International Economic & Energy Weekly [redacted]

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26 March 1982

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26 March 1982

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USSR: Economic Woes Continue 25X1

Following three consecutive years of GNP growth at less than 2 percent, the Soviet economy got off to an even worse start this year. In January and February civilian industrial production dropped below the same two-month period last year. Output fell in almost every major industrial sector except electric power and natural gas. The only previous decline from year-earlier levels occurred in January and February 1979 and was due to exceptionally harsh weather. 25X1

Although much of this year's slump stems from oil and coal shortages and transportation bottlenecks, the drop also reflects the increasingly taut state of the economy. Breakdowns in production and distribution in one sector reverberate throughout the entire system, idling capacity and disrupting production schedules. Industry's exceptionally dismal performance in January and February—coming on the heels of three successive years of record low growth rates—gives Soviet leaders cause for alarm. Another poor showing this year would further jeopardize the 11th Five-Year Plan (1981-85) and dash Moscow's hopes of rejuvenating industrial production in the short-to-medium term. 25X1

USSR: Industrial Production Growth — *Average Annual Percent*

	1971-75	1976-80	1980	1981
Total	**5.9**	**3.4**	**2.9**	**2.0**
Industrial materials	5.4	2.6	2.5	1.6
Electric power	7.0	4.5	4.5	2.3
Fuels	5.0	3.3	2.3	0.9
Nonferrous metals	5.9	2.6	0.8	0.3
Ferrous metals	4.0	1.1	−0.3	0.2
Wood, pulp, and paper	2.6	−0.1	2.8	2.2
Construction materials	5.4	1.8	1.0	1.2
Chemicals	8.6	3.8	5.2	3.5
Total machinery	7.9	5.4	4.4	2.6
Civilian machinery	9.0	5.8	3.8	1.8
Military machinery	4.5	3.4	6.6	~~X~~ 5-7
Consumer nondurables	3.4	1.6	0.1	2.1
Light industry	2.7	2.6	2.0	2.5
Processed food	3.9	0.7	−1.4	1.7

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1981 Results

The Economy. GNP grew at an estimated 1.8 percent in 1981, with all sectors performing in disappointing fashion. Farm output barely surpassed the depressed level of 1980, falling some 10 percent below the peak level achieved in 1978. The most striking negative development, however, was the decline in the growth of industrial production from 2.9 percent in 1980 to 2 percent in 1981—the smallest rise in the post-Stalin era.

Industry. The lackluster performance of Soviet industry—particularly the coal, steel, and machinery sectors—is a particularly bad omen for the Soviet economy. Falling coal production, for example, is undercutting Soviet plans to increase the use of coal in the generation of electricity and is a major constraint limiting the production of steel. The slow growth of construction materials, stagnant output of ferrous metals, and the lagging performance of civilian machine building imply that even the historically low rate of investment growth planned for 1981-85 (1.6 percent per year) may be unattainable. 25X1 25X1

The low growth of civilian machinery output must be particularly alarming to Soviet officials. New, more technologically advanced products are badly needed to renovate and modernize the aging capital stock in the USSR, to stimulate energy development and conservation, and to substitute for increasingly scarce labor resources. [redacted]

Energy. The growth in major fuels (oil, natural gas, and coal) production plunged to about 1 percent in 1981. Oil production increased 1 percent last year; an even smaller increment to output is targeted for 1982. Even though drilling activity increased by a record amount, delays in bringing crucial gas-lift oil recovery projects on stream and the lagging development of rail networks, all-weather roads, and electric power facilities have constrained production activity. [redacted]

Coal is probably the USSR's most pressing energy problem. Last year output of raw coal fell for the third year in a row—to 704 million tons, some 12 million tons less than the previous year and 34 million tons short of plan. Three major factors continue to hamper coal production: (1) deteriorating conditions—notably increasing depths and narrowing seam thickness at the larger, established mines; (2) insufficient investment resulting in delays in bringing new capacity, particularly open-pit mines, on stream in time to offset output declines at older basins; and (3) increasing labor intensity of operations coupled with difficulty attracting new laborers into the mining profession. [redacted]

In contrast to oil and coal, Soviet natural gas production increased almost 7 percent, with practically the entire increase coming from West Siberian fields. The USSR possesses a huge natural gas reserve base—almost 40 percent of proven world reserves. [redacted]

Agriculture. Serious harvest shortfalls were widespread last year. Grain production is estimated to have been no more than 170 million tons—19 million tons below 1980 and about 65 million tons below the plan target for 1981. The sugar beet crop dropped almost 25 percent to the lowest level since 1963, and potato production was up only slightly from the previous year's severely depressed level. A near record cotton harvest was the single exception to an otherwise dismal agricultural year. [redacted]

In the livestock sector, overall herd numbers increased slightly after stagnating in 1980 as increases in cattle and sheep offset a small decline in hog inventories. Figures on private herds, however, were not published in the annual plan-fulfillment report. We suspect that private livestock holdings may have fallen for the fourth consecutive year. Despite the regime's promise of increased support for private agriculture, feed supplies have become increasingly tight, and private farmers may be slaughtering their holdings or selling them to socialized farms. [redacted]

To compensate for the shortfalls in domestic production, large quantities of agricultural commodities again had to be imported in 1981. Hard currency imports—largely grain, other feedstuffs, meat, sugar, and vegetable oil—reached $12 billion, up sharply from $8.8 billion the previous year. Agricultural imports accounted for two-fifths of Moscow's total hard currency merchandise imports in 1981, compared with one-third in 1980. [redacted]

Capital Formation. The increase in commissionings of new plant and equipment slumped to 2 percent last year, reflecting both the low rates of growth of new fixed investment during the previous two years and the continuing inability of Soviet planners to significantly reduce the level of unfinished construction. Even though the level of unfinished construction fell in 1980 for the first time, the reduction was small—slightly over a billion rubles compared with a total value of unfinished construction of over 105 billion rubles. Preliminary information suggests that it may have increased again in 1981. [redacted]

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Consumer Welfare. Soviet living standards as measured by per capita consumption increased approximately 1.5 percent last year, about the same as in the previous year but less than the annual gains attained during the 1970s. Food supplies in state retail outlets continued to dwindle as increasing amounts were diverted to factories for distribution. The leadership clearly regards the food shortages as serious. At the November plenum, Brezhnev cited them as the most critical economic and political issue of the 11th Five-Year Plan. Meanwhile, the authorities invoked a system of purchase norms last summer in some areas—a type of informal rationing whereby purchases of both quality foods and bread and other cereal products are strictly limited. Formal rationing was instituted in several cities.

Large food imports are playing a major role in keeping food supplies at tolerable levels. Imports of meat last year, for instance, totaled an estimated record 925,000 tons. Per capita meat availability increased fractionally due to the growth in meat imports and a slight increase in domestic production, but still remained at about the 1975 level.

Leadership Response

Moscow still has not formulated a policy to deal with the economic slowdown. Nor have any new solutions for revitalizing effectiveness in planning and management been put forth. The essence of the Kremlin's program has been to stress the need for more innovation and technological change in industry; material savings and the conservation of fuel and other natural resources are also being emphasized. These programs are a replay of measures tried in the past with little success. The obstacles to innovation and technological change that have plagued the Soviets in the past—a cumbersome organizational structure, inflexible prices, and a perverse incentive system—remain unaltered. 25X1

It is difficult to be sanguine about Soviet plans for material and energy savings. The conservation targets set forth in the 11th Five-Year Plan and the strict standards for resource use established in a party-government decree last July are more an expression of what would have to happen to achieve balance than a reasoned estimate of what is possible. 25X1

There still are no indications that Moscow is any more willing now than in the past to make basic structural changes to the existing economic mechanism. Recent attempts at reform have been implemented sluggishly and with little enthusiasm. The comprehensive decree of July 1979, rather than resulting in significant reform, has spawned more centralized, rigid, and detailed planning than before. 25X1 Also the high-level interdepartmental council established last year to evaluate economic reform measures adopted in Eastern Europe still has not come forth with any proposals for the Soviet economy that deviate from established practices. 25X1

The Soviet leadership's basic message to the man in the street is only to "remind" him that harder times 25X1 are here, that the United States and corruption in Soviet society are largely to blame, that belts are going to have to be tightened, and that people are going to have to stop grumbling and work harder. 25X1

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